

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 IO-11 ISO-00 AGR-10 CEA-01

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R 101914Z MAR 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 9731

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

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UNCLAS SECTION 01 OF 03 LONDON 03803

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SUBJECT: ECONOMIC DEVELOPMENTS DURING THE PERIOD MARCH 4

TO MARCH 10, 1976

SUMMARY: AFTER 3 MONTHS OF UNBROKEN STABILITY, STERLING WAS SHAKEN BY A HEAVY WAVE OF SELLING WHICH RESULTED IN A 4.1 PERCENT DEVALUATION IN 3 DAYS. THE SIZE OF THE DECLINE IN STERLING COINCIDED WITH SIMILAR RECOMMENDATION INCLUDED IN THE QUARTERLY ECONOMIC REVIEW PUBLISHED BY THE NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH (NIESR). NIEQR FORECASTS A SLOW AND MODERATE RECOVERY IN 1976. WHOLESALE PRICE AND RETAIL SALES INDICATORS LEND SUPPORT TO THIS FORECAST. THE CHANCELLOR OF THE EXCHEQUER STRONGLY DEFENDED THE GOVERNMENT PUBLIC EXPENDITURE WHITE PAPER IN THE COMMONS. END SUMMARY

1. EXCHANGE MARKETS. THE POUND FELL TO A HISTORIC LOW DURING THE WEEK FOLLOWING A FLURRY OF SELLING WHICH BEGAN ON THURSDAY (MAR. 4). OVER THE COURSE OF THE WEEK, STERLING FELL 4.1 PERCENT (825 BASIS POINTS) FROM THE WEDNESDAY (3/2) CLOSING RATE OF \$2.0245 TO \$1.9415 ON TUESDAY (3/9). AT ONE POINT, THE RATE FELL AS LOW AS \$1.9280 ON MONDAY (3/8) BEFORE LARGE-SCALE SUPPORT BY THE BANK OF ENGLAND LED TO A HALT IN THE DECLINE. PRESS REPORTING ON THE CAUSE OF THE FALL HAS BEEN WIDE AND VARIED, RANGING FROM SPECULATION THAT THE BANK OF ENGLAND "FORCED" THE FALL, TO REPORTS THAT LARGE-SCALE DIVERSIFICATION OF NIGERIAN OFFICIAL RESERVES WAS MISMANAGED AND THE OPERATION "BACKFIRED." WHILE A LONGER TERM DECLINE IN THE STERLING RATE HAS BEEN LONG DISCUSSED IN THE MARKETS, MOST APPEAR SURPRISED AT THE RAPIDITY OF THE RECENT DECLINE AND THE LACK OF GOVERNMENTAL SUPPORT UNTIL THE \$1.93 LEVEL WAS REACHED. THE LACK OF SUPPORT HAS LED MANY TO SPECULATE THAT WHILE THE BOE DID NOT ACTIVELY "FORCE" THE RATE, THE DECLINE CAME ABOUT WITHOUT OFFICIAL RESISTANCE.

2. BALANCE OF PAYMENTS. ON A SEASONALLY ADJUSTED BASIS, THE CURRENT ACCOUNT WAS IN DEFICIT 306 MILLION POUNDS (REVISED FROM EARLIER REPORTED FIGURE OF 357 MILLION POUNDS) IN THE FOURTH QUARTER. THE REVISED TRADE DEFICIT WAS 683 MILLION POUNDS, 303 MILLION POUNDS BELOW THE UNCLASSIFIED

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THIRD QUARTER LEVEL. ON A NON-SEASONALLY ADJUSTED BASIS, THE CURRENT ACCOUNT DEFICIT DURING FOURTH QUARTER WAS 120 MILLION POUNDS. COMBINED WITH A 398 MILLION POUND NET OUTFLOW OF IDENTIFIED INVESTMENT AND OTHER CAPITAL FLOWS AND A POSITIVE BALANCING ITEM (ERRORS AND OMISSIONS) OF 299 MILLION POUNDS, THE NET CURRENCY OUTFLOW WAS 219 MILLION POUNDS WHICH WAS FINANCED BY DRAWING ON OFFICIAL RESERVES.

FOR THE YEAR AS A WHOLE, THE CURRENT ACCOUNT WAS IN DEFICIT 1,702 MILLION POUNDS, 53 PERCENT BELOW THE 1974 DEFICIT OF 3,450 MILLION POUNDS. THE VISIBLE TRADE DEFICIT WAS 3,200 MILLION POUNDS COMPARED TO 5,264 MILLION POUNDS IN 1974, WHILE THE SURPLUS ON INVISIBLE TRADE WAS REDUCED BY 114 MILLION POUNDS TO 1,498 MILLION POUNDS. IDENTIFIED CAPITAL FLOWS (EXCLUDING PUBLIC SECTOR BORROWING UNDER THE EXCHANGE COVER SCHEME) AMOUNTED TO A NET OUTFLOW OF 793 MILLION POUNDS COMPARED TO A NET INFLOW OF 1,611 MILLION POUNDS IN 1974. UNIDENTIFIED INFLOWS (ERRORS AND OMISSIONS) ROSE TO 1,020 MILLION POUNDS COMPARED WITH 363 MILLION POUNDS IN 1974. (NOTE: THE UNIDENTIFIED FLOWS (BALANCING ITEM) WILL MOST LIKELY BE REDUCED SUBSTANTIALLY AS ADDITIONAL FIGURES ON INVESTMENT AND CAPITAL FLOWS BECOME AVAILABLE.) BORROWING BY THE GOVERNMENT (INCLUDING THE PUBLIC SECTOR) WAS 806 MILLION POUNDS

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AND OFFICIAL RESERVES WERE DRAWN DOWN BY 669 MILLION
POUNDS. COMPLETE TABLES TO FOLLOW BY AIRGRAM.
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3. NIESR REVIEW CALLS FOR FURTHER WAGE RESTRAINT. THE
AUTHORITATIVE NATIONAL INSTITUTE FOR ECONOMIC AND SOCIAL
RESEARCH (NIEQR) CALLED FOR A SECOND PHASE OF INCOMES
POLICY BASED ON AVERAGE WAGE INCREASES OF ABOUT 6 PERCENT.
FORECASTING A MODEST (1.3 PERCENT) RECOVERY IN OUTPUT IN
1976, A CONTINUING REDUCTION IN INFLATION (TO ABOUT 10
PERCENT) AND A HIGH CURRENT ACCOUNT DEFICIT (2 BILLION
POUNDS), NIESR ASSERTS THAT MORE RESOURCES MUST BE SHIFTED
INTO THE BALANCE OF PAYMENTS BEFORE THE DOMESTIC ECONOMY
CAN BE SIGNIFICANTLY EXPANDED. THIS IMPLIES AN IMPROVE-
MENT IN THE PRICE COMPETITIVENESS OF UK EXPORTS. IN THE
ABSENCE OF IMPORT CONTROLS, THIS CAN RESULT EITHER BY
MEANS OF A DEPRECIATION OF STERLING, MONEY WAGES UN-
CHANGED; OR A SLOWING IN THE RATE OF GROWTH OF MONEY WAGES
THE EXCHANGE RATE UNCHANGED. WHILE THE LATTER, INVOLVING
LESS INFLATION IS PREFERABLE, NIESR CONCEDES THAT THERE
MAY BE DIFFICULTIES IN REDUCING THE RATE OF GROWTH IN
WAGES BEYOND SOME UNSTATED POINT. THEREFORE, STERLING
MUST DEPRECIATE TO
SOME EXTENT. A 5 PERCENT DROP IN STERLING'S VALUE IS
SEEN TO BE THE LARGEST THAT WOULD BE ACCEPTABLE WITHOUT
PROVOKING COMPETITIVE DEVALUATIONS AMONG BRITAIN'S TRAD-
ING PARTNERS. THIS WOULD CREATE ABOUT 200,000 JOBS AND
PROVIDE THE GOVERNMENT WITH ROOM FOR ABOUT 500 MILLION
POUNDS IN TAX RELIEF IN THE COMING BUDGET. WRITTEN JUST
PRIOR TO THE RECENT PUBLIC EXPENDITURE WHITE PAPER AND
THIS WEEK'S DEVALUATION OF STERLING, THE REPORT LENDS
SUPPORT TO THE GENERAL ARGUMENT THAT PUBLIC EXPENDITURE
MUST BE STABILIZED AND WAGE INCREASES HELD DOWN IF THE
GOVERNMENT'S MEDIUM TERM GOALS ARE TO HAVE ANY CHANCE OF

SUCCESSING.

NIESR ESTIMATES THE IMPACT OF BOTH A 6 AND A 20 PERCENT INCREASE IN WAGES ON EMPLOYMENT, PRICES AND OUTPUT, AND THE CURRENT ACCOUNT BALANCE. UNDER THE 20 PERCENT ASSUMPTION BY 1977 UNEMPLOYMENT IS 200,000 HIGHER, THE RATE OF INCREASE OF GDP IS MORE THAN HALVED, AND INFLATION IS NEARLY DOUBLED WHEN COMPARED WITH THE 6 PERCENT CASE. (FULLER DETAILS FOLLOW SEPTTEL.)

4. CHANCELLOR DEFENDS SPENDING PLANS. OPENING A TWO DAY DEBATE ON THE PUBLIC EXPENDITURE WHITE PAPER, THE UNCLASSIFIED

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CHANCELLOR OF THE EXCHEQUER FIRMLY STATED THAT A 5.5 AVERAGE ANNUAL GROWTH RATE OF GDP AND 8.5 PERCENT FOR MANUFACTURING OUTPUT DURING THE THREE YEARS THROUGH 1979 WOULD BE NEEDED TO REDUCE UNEMPLOYMENT TO 700,000 (ABOUT 3 PERCENT). THIS GROWTH RATE WAS IMPLICIT IN THE WHITE PAPER AND WAS BASED ON A LEVELLING OFF OF PUBLIC SPENDING. SHOULD THIS GOAL NOT BE ACHIEVED, MR. HEALEY PROMISED FURTHER TO REDUCE EXPENDITURE PROGRAMS RATHER THAN ANY INCREASES, SIR GEOFFREY HOWE, TORY SHADOW CHANCELLOR, CALLED FOR A CUT OF 4 BILLION POUNDS IN PLANNED EXPENDITURE RATHER THAN THE 3 BILLION CONTEMPLATED IN THE WHITE PAPER. HE WAS CRITICAL OF THE ADDED FUNDS FOR INDUSTRIAL INVESTMENT STATING THAT THE LION'S SHARE OF THESE WERE INTENDED TO SHORE UP LAME DUCKS.

5. INSTALLMENT CREDIT. IN LINE WITH RISING RETAIL SALES, GROSS HIRE PURCHASE AND OTHER INSTALLMENT CREDIT ROSE BY 286 MILLION POUNDS IN JANUARY. THE JANUARY FIGURE IS ABOUT 11 PERCENT HIGHER THAN THE AVERAGE MONTHLY TOTAL DURING THE FOURTH QUARTER OF 1975. THE NET INCREASE IN JANUARY WAS ADVANCED BY RETAILERS WHOSE OUTSTANDING DEBT INCREASED BY 18 MILLION POUNDS, OFFSETTING THE 6 MILLION POUND CONTRACTION IN DEBT OUTSTANDING TO FINANCE HOUSES.

6. RETAIL SALES. REVISED FIGURES SHOW THAT THE VOLUME OF RETAIL SALES IN JANUARY ROSE BY 2.6 PERCENT RATHER THAN THE 1.9 PERCENT PROVISIONALLY ESTIMATED. AS A RESULT THE INDEX OF RETAIL SALES VOLUME (1970 EQUALS 100) WAS INCREASED TO 109.8 FROM 109.0. THE MORE BUOYANT VOLUME IS ATTRIBUTED TO THE RELAXATION IN INSTALLMENT BUYING RESTRICTIONS ANNOUNCED BY THE CHANCELLOR IN DECEMBER. LEADING THE UPTURN WERE SALES OF DURABLE GOODS WHICH INCREASED BY 6 PERCENT IN JANUARY.

7. BANK LENDING TO PRIVATE SECTOR. BANK LENDING TO THE PRIVATE SECTOR REMAINS VERY LOW, REFLECTING WEAK DEMAND. DURING THE MONTH ENDING FEBRUARY 18, THE LEVEL OF AD-

VANCES TO THE PRIVATE SECTOR BY THE 5 UK CLEARING BANKS
FELL BY 99 MILLION POUNDS (DOWN 0 7 PERCENT) REFLECTING
THE CONTINUINE LOW LEVEL OF BUSINESS DEMAND. LENDING TO
MANUFACTURING INDUSTRY AS A WHOLE WAS OFF BY 37 MILLION
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POUNDS (DOWN 0.9 PERCENT) DURING THE QUARTER ENDING FEBRUARY 18 WITH THE LARGEST DROPS OCCURRING IN "FOOD, DRINK
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AND TOBACCO" AND METAL MANUFACTURE. INCREASES WERE RECORDED FOR THE CHEMICALS, VEHICLES, AND TEXTILES SECTORS. LENDING TO MINING, CONSTRUCTION ROSE SLIGHTLY AS DID ADVANCES TO FINANCE, REAL ESTATE AND INSURANCE COMPANIES. ADVANCES TO THE SERVICES SECTOR WERE SLIGHTLY LOWER AS NET REPAYMENTQ FOR TRANSPORT, COMMUNICATIONS, AND RETAIL INSTITUTIONS EXCEEDED NET BORROWING ON LOCAL GOVERNMENT SERVICES, OTHER DISTRIBUTION AND PROFESSIONAL SERVICES. PERSONAL(I.E., HOME PURCHASES AND OTHER LOANS) AND OVER. SEAS ADVANCES WERE POSITIVE OVER THE QUARTER. THE GRAND TOTAL FOR THE 3-MONTH PERIOD SHOWS AN INCREASE IN ADVANCES OF 137 MILLION POUNDS, UP 2.7 PERCENT ON AN ANNUAL BASIS.

8. WHOLESALE PRICES. THE INDEX (1970 EQUALS 100) OF WHOLESALE PRIAE FOR RAW MATERIALS AND FUELS (INPUTS) STOOD AT 263.0 IN FEBRUARY. A RISE OF 0.8 PERCENT OVER THE JANUARY FIGURE OF 160.9. THIS INDEX HAS RISEN AT A RATE OF 20.2 PERCENT OVER THE PAST YEAR. THE ANNUALIZED RATES OF INCREASE OVER THE PAST SIX MONTHS AND THE PAST 3 MONTHS ARE 17.9 AND 9.1 PERCENT RESPECTIVELY. THIS WEEK'S STERLING DEPRECIATION SHOULD ADD ABOUT 2 PERCENTAGE POINTS TO THE RATE OD INCREASE ON THIS INDEX OVER THE REMAINDER OF 1976 THE WHOLESALE PRICE INDEX FORFINISHED MANUFACTURERS (OUTPUTS) STOOD AT 106.9 IN FEBRUARY, A RISE OF 1.0 PERCENT OVER THE JANUARY FIGURE OF 104.9. THE 12, 6, AND 3 MONTH RATES OF INCREASE FOR OUTPUT PRICES ARE 17.6, 13.9 AND 16.6 PERCENT RESPECTIVELY. THE INCREASE OVER THE PAST THREE MONTHS IS LARGELY DUE TO THE BU//CHING OF PRICE INCREASES THAT OCCURRED IN JANUARY MUCH OF WHICH MAY HAVE BEEN IN ANTICIPATION OF THE ADDITIONAL PRICE CONTROLS WHICH WERE IMPOSED IN FEBRUARY.

9. EXCHANGE PATE AND GOLD

EXCHANGE	EFFECTIVE
DATE	RATE (\$)
	DEPRECIATION
	GOLD

(PERCENT)

3/3	2.0245	30.1	132.50
3/4	2.0140	30.3	132.75
3/5	1.9820	31.5	134.00
3/8	1.9425	33.1	133.00

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3/9	1.9415	33.2	133.25
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CHANGE 3/2-3/9 DN 0.0825 WIDENED 3.1 UP 1.75

10. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/3	0.65	1.85	3.55
3/4	0.58	1.70	3.40
3/5	0.80	2.05	3.90
3/8	0.82	2.00	3.65
3/9	0.70	1.77	3.55

CHANGE 3/2-3/9 UP 0.08 UP 0.10 UP 0.05

(ALL FIGURES IN CENTS)

11. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/3	5-1/8	5-3/4	6-1/2
3/4	5-1/4	5 3/4	6-1/2
3/5	5.5/8	6-1/8	6.1/2
3/8	5-1/4	5-5/8	6-3/8
3/9	5-1/4	5-3/4	6-1/2

CHANGE 3/2-3/9 DN 1/4 DN 1/4 DN 1/4

12. STERLING AERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/3	8-1/2	8-11/16	9
3/4	8-1/2	8-5/8	8-15/16
3/5	8-1/2	8-11/16	9
3/8	8-1/2	8.11/16	9.3/32
3/9	8-11/16	8 5/8	9-1/16

CHANGE 3/2-3/9 UP 1/8 DN 1/8 UP 1/16

13. THE MINIMUM LENDING RATE WAS REDUCED BY THE 1/4 POINT
ON FRIDAY FEBRUARY 5, TO 9 PERCENT. ARMSTRONG

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